



# COMMISSION NEWS

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ARIZONA CORPORATION COMMISSION, 1200 W. WASHINGTON, PHOENIX, AZ 85007

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CONTACT: Heather Murphy (602) 542-0844

## THE DIRTY DOZEN: SCAMS, SCHEMES AND RISKY INVESTMENTS

PHOENIX – The Arizona Corporation Commission’s Securities Division today released a list of the worst investment scams over the last year. In addition to some perennial scams that should be avoided at all cost, the Securities Division highlights other investments that may be legitimate but which investors should approach with caution, including long-term callable certificates of deposit (with 10- to 20-year maturities), gift annuities and mortgage-backed securities. State securities regulators estimate that securities fraud costs Americans billions of dollars each year.

“Our investment markets have continued to be volatile in 2002, and investors – particularly older Americans – may look for low risk and high return havens for their savings,” said Arizona Corporation Commission Chairman Bill Mundell. “Con artists make it appear that they can accommodate this goal by pitching their investments as low risk and high return, but that is an impossible combination. Investors must not forget the one constant in investing: the higher the return, the higher the risk.”

Commissioner Jim Irvin characterized this year’s list as “running the gamut from the mundane to the exotic – from broadly marketed promissory notes, and unregistered securities to bogus prime bank schemes and risky viatical settlements (interests in the life insurance policies of supposedly terminally ill people).”

Commissioner Marc Spitzer observed that several cases this year have involved unregistered securities or sales of investment products by unlicensed individuals. “The difference in our recent cases is that the people selling dangerous investments are moving out of clandestine boiler rooms and onto Main Street – they’re the neighbors or friends that you’ve dealt with for years. Sometimes, the people offering these products are members of a respected profession such as insurance or accounting who then use that respect to sell risky or unregistered

investments to their customers.”

Here is a list of the top scams, ranked roughly in order of prevalence or concern:

1. **Unregistered individuals, such as life insurance agents, selling securities.** Over the last year, the Commission’s Securities Division has investigated and prosecuted 18 insurance agents who have sold investments without proper registration. These cases represent some of the top scams over the last several years, including unregistered promissory notes, viatical contracts and prime bank schemes. With a quick call to the Securities Division, anyone can check the registration status of a security or salesperson.
2. **Promissory notes.** These are short-term debt instruments issued by little-known or sometimes non-existent companies that promise high returns – upwards of 15 percent monthly – with little or no risk. Again, less scrupulous independent life insurance agents market many of these investments. Arizona residents have lost well over \$10 million in bogus promissory note scams uncovered by Commission investigators. Many of the cases involve elderly investors who, believing the claims of the salesperson, risked the bulk of their savings. In one case, the perpetrator used investors’ money to buy a yacht and maintain a lavish life style, instead of constructing a promised storage facility.
3. **Prime bank schemes.** Investors are promised triple-digit returns through access to the investment portfolios of the world’s elite banks. Promoters of these schemes often target people skeptical of the government and other institutions, promising access to the “secret” investments used by the super rich. Arizona investigators have uncovered several multimillion dollar prime bank schemes and the Arizona Corporation Commission ordered restitution for losses in the bogus programs.
4. **Viatical settlements.** Originating as a way to help the gravely ill pay their bills, these interests in the death benefits of terminally ill patients are always risky and sometimes fraudulent. The insured gets a percentage of the death benefit in cash, and the investors get a share of the death benefit when the insured dies. These investments are extremely speculative because it is impossible to predict accurately when someone will die. In a new twist, the Securities Division says that “senior settlements” – interests in the

death benefits of healthy older people – are now being offered to investors.

5. **Internet fraud.** Scam artists use the wide reach and supposed anonymity of the Internet to “pump and dump” thinly traded stocks, peddle bogus offshore “prime bank” investments and publicize pyramid schemes. In 2000, the Commission’s Securities Division launched an Internet fraud enforcement team that investigates suspicious investment schemes and follows up on investor complaints. The Corporation Commission urges investors to ignore anonymous financial advice offered on the Internet and in chat rooms.
6. **Mining Scams.** Perhaps mining scams are prevalent in Arizona because people know Arizona has a rich history of mining and mineral deposits. Or it may be because of peoples’ fantasies of the rugged, wild West or the gold rush days but whatever the reason, Arizona has a rich history of mining scams and schemes. The reality is that there are no known technologies for extracting gold or other precious metals from coal ash, asphalt waste products or slag piles. The Commission encourages everyone to remain very skeptical of the hype surrounding such claims.
7. **Charitable gift annuities.** The year 2001 saw an increase in investor complaints regarding charitable gift annuities. Charitable gift annuities are issued by a charity that promises a safe, steady income, tax benefits and a means to effect charitable donations. In the problem offerings, the charity promises that the annuities are backed by funds invested in stocks, bonds, money market funds and federal obligations, but the Securities Division finds that the annuities have not maintained the reserves to back up the investors’ funds. Hundreds of investors have been left with an unsecured obligation of the issuer and no income.
8. **Mortgage-backed securities.** These are investments that are secured by mortgages or deeds of trust on a piece of property generally owned without any other encumbrance. The payments come from the payments on the mortgage or deed of trust. Mortgage-backed securities are often sold as being safer than other investments because the debt is secured by real estate. These investments involve risks, however. It may be difficult to liquidate the investment if the investor has an immediate need for his or her money or the value of the real estate may be exaggerated due to faulty appraisals. Another pitfall is that the borrower may default on the loan and the property could be sold for less than the amount of the loan.

9. **Ponzi/pyramid schemes.** Always in style, swindlers promise high returns to investors, but the only people who consistently make money are the promoters who set the pyramid scheme in motion, using money from previous investors to pay new investors. Inevitably, the schemes collapse.
10. **“Callable” CDs.** These higher-yielding certificates of deposit won’t mature for 10 to 20 years, unless the bank, not the investor, “calls” or redeems them. Redeeming the CD early may result in large losses – upwards of 25 percent of the original investment. The Corporation Commission’s Securities Division has taken many complaints from retirees in their 70s and 80s who unwittingly invested thousands of dollars in “callable” CDs with 20-year maturities. These investors often need immediate access to their funds to pay nursing home bills, medical treatment costs or other living expenses. The Securities Division believes that many sellers of callable CDs don’t adequately disclose the risks and restrictions.
11. **Investment seminars.** Often the people getting rich are those running the seminar, making money from admission fees and the sale of books or audiotapes. These seminars are marketed through newspaper, radio and TV ads and “infomercials” on cable television. The Corporation Commission urges investors to be extremely skeptical about any get-rich-quick scheme.
12. **Boiler rooms.** These operations consist of offices in which salesmen, who may or may not be registered, use high pressure sales tactics to sell a variety of dubious securities to prospective investors. Salesmen operating out of these boiler rooms can make up to 200 or more unsolicited calls a day, often resorting to deceptive sales ploys to sell the investments. The typical boiler room will seek to generate several million dollars in investment monies, and then fold the operation only to reappear at a different location under another name with a new investment to sell.

The public is encouraged to investigate investment opportunities before investing by contacting the Securities Division at 602-542-4242, toll free at 1-877-811-3878, or visiting its website at [www.ccsd.cc.state.az.us](http://www.ccsd.cc.state.az.us).